

BUDGET BRIEF:
2012 PROPOSED
CITY OF MILWAUKEE BUDGET

October 2011

Study authors:

Vanessa Allen, Researcher
Rob Henken, President



TABLE OF CONTENTS

INTRODUCTION.....	3
THE 2012 BUDGET ENVIRONMENT	4
2012 BUDGET THEMES.....	5
ANALYSIS OF SIGNIFICANT 2012 BUDGET CHANGES.....	6
Major Revenues	6
Major Expenditures.....	8
Departmental Highlights	10
PREPARING FOR THE FUTURE	12
Rising pension payments	12
The reality of a new property tax levy limit.....	13
State of city reserves.....	13
CAPITAL PROJECTS.....	14
CONCLUSION	15

INTRODUCTION

The 2012 proposed budget for the City of Milwaukee represents a second consecutive year of relative calm before a likely return of dark fiscal storm clouds. Dramatic savings related to employee benefits allow the city to offset state budget impacts and get by, for the most part, without significant cuts in valued services. Massive spikes in property tax levy-supported pension payments, however, as well as the loss of federal funds and flat or declining state revenues, pose a potentially serious threat to city services in 2013 and beyond.

With this in mind, the mayor has proposed a 2012 budget that not only provides residents another year of sustained (and in some cases enhanced) city services, but that also bolsters the city's pension reserve fund for the future. He is able to accommodate those actions with a small increase in the property tax levy and relatively modest increases in city fees. The key is the state budget repair bill, which initially allows the city to offset the impact of state aid reductions by requiring substantially larger health care contributions from most employees, and by redesigning its health care offerings.

Building the city's pension reserve and restructuring its health care plan design will positively impact the city's finances in the future, yet that future remains quite uncertain. Among the key questions facing city leaders will be the extent to which they should continue to use the flexibility granted by the state budget repair bill to reduce employee health care benefits on an annual basis; whether to also use that flexibility to contemplate additional cost-saving changes in employee compensation, work rules and other benefits; and whether to make greater use of privatization initiatives in areas like public works.

As virtually all local governments and school districts are realizing, the budget repair bill "tools" can be used annually on a unilateral basis to ratchet down personnel costs. Barring an unlikely decision by state elected leaders to restore lost shared revenue, city officials must decide how to balance the use of those tools to offset growth in fixed costs versus the desire to retain valued workers and maintain employee morale and productivity.

In the pages that follow, we highlight the major provisions of the budget document and critically evaluate their impact upon both city services and area residents. We also discuss some new program initiatives, and we consider how the 2012 budget impacts city finances in the long term. Our intent is to contribute to a more objective and informed debate on the City of Milwaukee's 2012 budget.

THE 2012 BUDGET ENVIRONMENT

The 2012 budget is the city's first following the passage of Wisconsin Act 10 (also known as the state budget repair bill) and the 2011-13 state budget. Those landmark laws impact city finances in meaningful ways, including eliminating the need to engage in collective bargaining on health care and pension benefits for non-public safety employees; reducing shared revenue payments; and limiting annual property tax levy increases.

Contemplating the benefits and drawbacks of the new laws from the perspective of city finances is a murky task, as some positives and negatives are more certain, immediate and quantifiable than others. It is clear, however, that the grave initial concerns about short-term impacts have not materialized in 2012, as the mayor and his budget staff have been able to propose a budget that avoids severe service cuts or the need for typical increases in the property tax levy.

Most concerning to city officials was the state budget's reduction of shared revenue to local governments, which is the largest source of revenue in the city's operating budget, and its second largest source of revenue overall (behind only the property tax). Milwaukee's overall reduction in state aids for 2012 is \$13.4 million¹, with lost shared revenue making up \$9.9 million of that amount. As it turned out, however, the flexibility permitted by the state budget repair bill – along with other city initiatives to reduce health care costs – more than matched those reductions in state aid, at least for 2012.

Indeed, the city's ability to redirect savings from reduced employee health care and pension costs has allowed the mayor not only to avoid service reductions and substantial revenue increases in 2012, but also to restore some recent budget reductions and enhance the city's efforts to prepare for the future. A \$49 million increase in the city's pension contribution in 2010 necessitated several service cuts, as well as draws from city reserves and substantial increases in the property tax levy and fees. When the need for a similar contribution disappeared in 2011, the city reversed some of those 2010 actions while also putting away an additional \$17 million in its pension reserve. The 2012 budget benefits from the lack of a required pension fund contribution as well, and uses that good fortune – plus health care and other pension savings – to increase the city's contribution to the pension reserve, thus helping to prepare for future years when annual pension contributions of \$58 million to \$80 million are expected.

It is important to note that when and if those large pension contributions return, the new state levy cap will limit the city's option to respond with property tax increases. In addition, cushion in departmental budgets that may have existed prior to 2010 is unlikely to be available, and the substantial health care savings achieved under the state budget repair bill will have been exhausted. Adding to future budget struggles will be the likely continued decline in federal grants, including Community Development Block Grant (CDBG) revenue and American Recovery and Reinvestment Act (ARRA) funding.

Consequently, the city's 2012 budget should be seen as a second and final year of "calm" before storm clouds begin to gather. The mayor and his budget staff deserve credit for recognizing that reality and taking several important steps to prepare for a troublesome fiscal future. Nevertheless, despite their preparations, it is likely that several successive years of difficult budget decisions await city leaders.

¹ This figure includes both a reduction of \$12.3 million in intergovernmental revenue budgeted in the general fund and a \$1.1 million reduction in recycling grant revenue budgeted in the grant and aid fund.

2012 BUDGET THEMES

Health care and pension savings are a major theme of the 2012 proposed budget, allowing the mayor to adequately fund his major priorities and limit revenue increases. According to budget officials, health care and pension savings in 2012 will total approximately \$36.8 million. A substantial portion of those savings are linked to the requirements and flexibility provided in the state budget repair bill, though some also are attributed to changes in health care administration and plan design that the city would have pursued regardless. Taking into account the state aid reduction of \$13.4 million resulting from the recent state budget, the city was able to derive a net total “savings” of \$23.4 million to put toward city services, build reserves and limit property tax levy growth.

As seen in **Table 1**, total general fund expenditures in the proposed budget decrease by \$1 million, or 0.2%.² General fund expenditures reflect not only those incurred for city operations, but also health care costs, which are reduced dramatically in 2012. When health care costs are subtracted from general fund expenditures, those expenditures *increase* by \$27.5 million in 2012, or 6.2%. An increase of that magnitude has not been seen since 2007, when departmental expenditures increased \$26.3 million, or 6.1%. This analysis shows that despite the small increase in property taxes and the reduction in state aids, city departments collectively see expenditure growth similar to that seen in better economic times. Such an occurrence would have been unlikely without employee benefit changes.

Table 1: Changes in the City's General Purpose Budget, 2007 to 2012

	2007	2008	2009	2010	2011 Adopted Budget	2012 Proposed Budget
General Fund expenditures	\$560,989,488	\$578,290,417	\$584,850,286	\$578,281,923	\$591,097,740	\$590,054,479
<i>% Increase from prior year</i>	6.9%	3.1%	1.1%	-1.1%	2.2%	-0.2%
Expenditures without health care	\$458,911,029	\$468,071,998	\$471,510,669	\$451,404,298	\$446,315,410	\$473,854,479
<i>% Increase from prior year</i>	6.1%	2.0%	0.7%	-4.3%	-1.1%	6.2%

Source: City of Milwaukee, annual adopted budgets and the 2012 Proposed Plan and Executive Budget Summary

Another key theme of the proposed budget is its commendable effort to use some of the fringe benefit savings and other resources to increase the city's voluntary contribution to the pension reserve to \$25 million, for a total fund balance of \$54 million. Building these reserves is prudent considering the city's anticipation that it will face several successive years of large pension contributions beginning in 2013.

Finally, losses in grant funding and state aids are peppered throughout city departments, constituting another important theme likely to re-occur in future years. In several instances, the budget replaces lost grant and aid revenue with property tax levy freed up by fringe benefit savings. For example, reduced CDBG revenue impacts several departments, most notably the Department of Neighborhood Services and the city library. In both cases, the budget proposes additional tax levy to maintain services.

² General fund expenditures do not include pension costs, which are budgeted in a separate fund.

ANALYSIS OF SIGNIFICANT 2012 BUDGET CHANGES

A more detailed look at major revenue and expenditure line items in the 2012 proposed budget further defines the general themes described in the previous section. This section highlights those items, particularly as they relate to the priorities established by the mayor in the proposed budget.

Major Revenues

Table 2 cites the major revenues supporting the city's general fund operations. The most dramatic change comes in the form of reduced shared revenue from the state. A reduction to the Tax Stabilization Fund (TSF) withdrawal also is proposed. The solid waste fee structure is altered, representing the biggest fee increase proposed for the general fund. Increases also are recommended for fees budgeted in the sewer maintenance fund. Other revenue sources largely remain flat.

Table 2: City of Milwaukee major revenues, 2011 adopted and 2012 proposed budget

Revenue Category	2011	2012	Difference	% Change
Intergovernmental revenue	\$271,595,500	\$259,501,500	\$(12,094,000)	-4.5%
State shared revenue	\$228,345,000	\$218,490,000	\$(9,855,000)	-4.3%
Other revenue	\$43,250,500	\$41,011,500	\$(2,239,000)	-5.2%
Property tax levy*	\$246,703,278	\$248,269,602	\$1,566,324	0.6%
Charges for services	\$99,817,832	\$102,577,987**	\$2,760,155	2.8%
Licenses, fees & fines	\$17,683,200	\$17,951,600	\$268,400	1.5%
Taxes and payment in lieu of taxes	\$16,534,500	\$16,147,300	\$(387,200)	-2.3%
Miscellaneous revenue	\$35,291,900	\$38,244,900	\$2,953,000	8.4%
Tax Stabilization Fund (TSF)	\$14,600,000	\$13,767,000**	\$(833,000)	-5.7%

* Includes all property tax revenues, which support both the general operating budget and other funds; all other revenues support the general purpose operating budget.

** This does not include an anticipated \$1.4 million from a proposed increase in garbage cart and solid waste fees. The budget reflects an additional \$1.4 million within the TSF that no longer would be reflected at budget adoption should the fee increases be recognized in that amount by the city's Comptroller and approved by the Common Council.

Source: City of Milwaukee 2012 Proposed Plan and Executive Budget Summary

The following provides a more detailed description of major revenue items:

- *Property Tax* – Wisconsin Act 10 limits property tax growth to the increase of net new construction from the previous year. The proposed budget uses most – but not all – of the room provided under this limit. Overall, property taxes would increase by \$1.6 million, or 0.63%, to \$248.3 million. Due to declining property values, however, the tax rate would increase at twice that percentage, or 1.2%, from \$9.12 to \$9.23 per \$1,000 of assessed value. The amount of property taxes dedicated to general fund expenditures increases by \$3.9 million, including \$2 million that is redirected from the Employees' Retirement Fund and roughly \$300,000 no longer needed to support debt service costs. Property tax-supported debt service declines by \$409,000 to \$68.8 million.
- *Intergovernmental Revenue* – Intergovernmental revenue supports 44% of the general operating fund, making it the city's largest revenue source. This funding was significantly impacted by a \$13.4 million reduction in state aids adopted in the State of Wisconsin 2011-13 Biennial Budget. This

includes a shared revenue reduction of \$9.9 million, a cut to local street aids of \$2.4 million, a \$1.1 million reduction in the city's recycling grant, and a \$100,000 loss in municipal service payments.³

- *Charges for Services* – The \$2.8 million increase in this category largely reflects additional revenue from fee increases approved after adoption of the 2011 budget. This includes \$2.4 million from increases in the snow and ice control fee and neighborhood services property inspection and registration fees. The proposed budget does not recommend further increases to those fees.

Another \$2.4 million is from continuation of the city's "40 by 2020" solid waste diversion initiative, which aims to induce greater recycling and the diversion of 40% of the city's solid waste from landfills by 2020. Under this initiative, the city expects an elevated amount of recycled materials to be available for sale, producing \$1 million in additional revenue. In order to further incentivize lower levels of solid waste, residences with multiple garbage carts will now be charged \$10 quarterly for every additional cart after the first, an increase of \$5. The proposed budget also recommends an increase to the solid waste fee for a single cart, from \$168.16 to \$171.52 annually. These fee increases are projected to bring the city an additional \$1.4 million in 2012.

The storm water management fee and local sewerage charge both increase 5%, generating an additional \$1.8 million in 2012. Both fees are used to support the upkeep of city sewers. The city's expanded efforts and investments in controlling private property infiltration and inflow (I&I) will likely necessitate future fee increases. Both the storm water and sewerage charges are projected to continue a climb of 5% annually, which will allow the city to maintain a 90-year replacement cycle.

- *Miscellaneous revenue* – There is a proposed increase of \$3 million in miscellaneous revenues for 2012. A \$3.2 million shift in vehicle registration fee revenue from the debt service fund to the general operating fund overshadows other adjustments within this category. Since the enactment of the vehicle registration fee in 2009, debt service payments have steadily declined, and property tax levy-supported debt service in 2012 declines further by \$400,000, to a total of \$68.8 million. City officials say these stabilizing debt service payments justify the redirection of vehicle registration fee revenue, which will be used for street maintenance in the general operating budget.

For the second consecutive year, the transfer from the parking fund to the general fund declines in 2012 as a result of declining parking reserves. The 2012 decrease is \$987,000 for a total of \$19.8 million. Transfers are expected to continue to decline by \$1 million annually for the next five years unless other revenue initiatives are adopted. Further demand on the parking fund may occur in the future, most notably if and when the city begins to operate a downtown streetcar system. The city anticipates the streetcar to be up and running by the fall of 2014, at which point \$1.5 to \$2 million in parking revenue may be diverted from the parking fund annually to support streetcar operations.

- *Tax Stabilization Fund* – A withdrawal of \$13.8 million from the TSF is proposed, a decrease of \$833,000 from 2011. The proposed withdrawal constitutes nearly 50% of the \$29.2 million currently available in the fund. Though the city has decreased its withdrawal, the proposed amount could be questioned in light of the fierce budget pressures facing the city in subsequent years, and the relatively modest property tax increase proposed for 2012. The possibility of preserving city reserves for later use is discussed later in this report.

³ Recycling grant revenue totals \$2.4 million in the proposed 2012 budget, a decline of 31.6%. This is budgeted in the grant and aid fund and not reflected in Table 2 as "intergovernmental revenue."

Major Expenditures

Without question, the most impactful expenditure change in 2012 involves employee fringe benefits. As discussed above, the magnitude of health care and pension savings arising from increased employee contributions and plan redesign frees up dollars to support departmental needs and increased pension reserves.

Health care

Employee fringe benefit costs largely consist of health care and pension costs, and make up roughly a quarter of the city's operating budget. Because of the city's use of Act 10 flexibility and other factors described earlier, health care and pension costs decline as a percentage of employee salaries in the proposed budget, from 65.3% in the 2011 adopted budget to 51.5% in the 2012 proposed budget.⁴

Significant changes to the city's health care offerings comprise much of this decrease. The \$28.6 million in total health care savings results from new health care plans with lower premium costs and greater cost-sharing measures, including increased employee premium contributions, increased deductibles and higher co-insurance costs for enrollees. The plan also is modified to better align costs and contributions with the number of people enrolled under an employee's family coverage.

With the health care changes outlined in the 2012 proposed budget, health care expenditures will decline by 20% to \$116.2 million. As seen in **Table 3**, this is a considerable contrast from previous years.

Table 3: Change in fringe benefit expenditures compared with change in intergovernmental and property tax revenues, 2008 to 2012

	2008 Change		2009 Change		2010 Change		2011 Adopted change		2012 Proposed change	
	\$	%	\$	%	\$	%	\$	%	\$	%
Major fringe benefit expenditures										
Health	\$8,139,960	8.0%	\$3,121,198	2.8%	\$13,538,008	11.9%	\$17,904,705	14.1%	(\$28,582,330)	-19.7%
Pension*	(\$930,829)	-2.3%	(\$4,300,000)	-10.7%	\$45,956,100	128.1%	(\$21,831,530)	-26.7%	(\$1,996,513)	-3.3%
Intergovernmental and property tax revenues										
Intergovernmental	(\$1,441,263)	-0.5%	\$1,239,080	0.5%	(\$1,398,026)	-0.5%	\$656,669	0.2%	(\$12,094,000)	-4.5%
Property tax (non-capital)	\$6,661,020	4.7%	\$15,366,027	10.3%	\$8,402,470	5.1%	\$3,556,151	2.1%	\$1,856,871	1.1%

*Property tax levy-supported pension payments.

Source: City of Milwaukee, annual adopted budgets and the 2012 Proposed Plan and Executive Budget Summary

These changes will not only lower the amount spent in 2012, but also are expected to help shrink annual growth in the future. **Table 4** provides further details on the major changes between the current and proposed 2012 plan structures that will assist in this cost reduction.

⁴ This does not reflect contributions to the city's pension reserve.

Table 4: Health care premium cost and plan design changes proposed for 2012*

		HMO-equivalent				PPO-equivalent			
		Single		Family		Single		Family	
		Current	2012	Current	2012	Current	2012	Current	2012
Premiums	Total monthly cost	\$746	\$624	\$2,037	\$1,872	\$980	\$794	\$2,208	\$2,381
	Employee monthly contribution	\$20	\$75	\$40	\$225	\$75	\$95	\$150	\$286
	Contribution as % of total	2.7%	12%	2.0%	12%	7.7%	12%	6.8%	12%
Co-insurance	In network	\$10 office visit co-pay	10% after deductible	\$10 office visit co-pay	10% after deductible	20%	10% after deductible	20%	10% after deductible
	Out of network	no coverage	no coverage	no coverage	no coverage	20%	30% after deductible	20%	30% after deductible
Deductibles	In network	none	\$500	none	\$1,000	\$100	\$750	\$300	\$1,500
	Out of network	no coverage	no coverage	no coverage	no coverage	\$100	\$1,500	\$300	\$3,000

*The city currently has a two-tiered system with one cost structure for an individual plan and another for a family plan. The 2012 proposed budget creates further variation and establishes a four-tiered system. The four tiers include different cost structures for individuals, employees plus dependents, employees plus spouse, and families. This table only provides comparisons between the single and family plan components.

Note: The city's 2012 HMO-equivalent plan would more appropriately be referred to as the Choice EPO. The city's PPO plan was referred to as the Basic plan in 2011 and will now be called the Choice Plus plan in 2012.

Source: City of Milwaukee Budget and Management Division staff

As shown, employees are now picking up a far greater portion of their health care costs. However, the city has done more than shift the cost burden; it also has managed to reduce its total costs, in part with efforts undertaken even before the budget repair bill was proposed. For example, the city's decision to move from an insured HMO to a self-funded plan saved \$6 million, largely by removing the profit margin previously paid within the HMO insurance contract.

Pension

The city has another year of relief with regard to pension costs in 2012. As mentioned earlier, the city benefited in 2011 from not having an actuarially required employer pension contribution, in contrast to its \$49 million contribution in 2010. Savings created from the elimination of that payment in 2011 were allocated to strengthen departmental service levels, build reserves, and freeze property taxes. The city avoids a contribution in 2012 as well, and the proposed budget also assumes an additional \$8.2 million in relief from the Wisconsin Act 10 requirement for employees to pay the employee share of annual pension contributions, a cost previously paid by the city. That contribution would be 5.5% of salary for general employees and 7% for elected officials.

There is considerable uncertainty, however, regarding the applicability of Wisconsin Act 10 with regard to the city's pension obligations as established by city ordinance and settlement agreements. Though the proposed budget assumes that city workers must comply with required employee pension contributions, the city attorney has opined that the city is obligated to pay those contributions on behalf of employees. In particular, he has cited the city's authority over its own pension plan, as established in the city's home-rule charter; the contractual rights of vested employees; and consent to the city's global pension settlement in 2000 as factors that block the state's ability to impose Act 10 on the City of

Milwaukee. In accordance with the city attorney's opinion, the city comptroller has stated he does not intend to withhold pension contributions from employee pay regardless of whether the contributions are included in the 2012 budget.

Resolution of this matter may take several months and is unlikely to occur before the 2012 budget is adopted. Consequently, the proposed budget sets aside a contingency of \$8.2 million – the same amount assumed from employee pension contributions – in case the city attorney's opinion prevails and the city must pay the contributions on behalf of employees. If that is not the case, then the mayor has indicated that the \$8.2 million would be redirected to eliminate the four proposed furlough days and potentially increase employee wages, which are frozen for general city employees.

The budget uses a sizeable share of the savings from health care and pension costs to make another considerable contribution to the city's pension reserve fund, in the amount of \$25 million. This contribution is \$7.7 million more than the \$17.4 million contribution in 2011. The magnitude of these contributions reflects the city's preparation for several future years of actuarially required pension payments that are expected to average more than \$70 million annually.

Changes to public safety compensation

Wisconsin Act 10 did not impact public safety employees in the same manner as general public employees. In fact, public safety unions retain the ability to collectively bargain for most forms of compensation, with the notable exception of health care plan design. Despite this exclusion, the firefighters and police commander unions tentatively agreed to new labor contracts that require the same 12% health care contribution as general employees in 2012 (the contracts also provide 4% pay increases and do not require pension contributions, however). The largest public safety union, the Milwaukee Police Association, has yet to come to an agreement with the city: the union's membership voted 52% to 48% to reject a contract with provisions similar to the other public safety unions' contracts.

Given the closeness of this vote and the tentative agreement reached with other public safety unions, the budget assumes that all employees, both general and public safety, will contribute equally to their health care costs in 2012. The budget does not assume, however, that members of public safety unions will contribute to pension costs similar to general city employees. [That savings would have amounted to an additional \$16 million if required under the state budget repair bill.]

Departmental Highlights

Adjustments to departmental budgets beyond fringe benefits are minimal, but there are a few notable changes. In particular, loss of grant and aid funding, especially in the area of CDBG funding, has placed pressure on the city to add property tax levy to various services. The proposed budget is able to accommodate that need in several instances, in addition to identifying ways to restore cuts made in previous years.

- *Fire* – While most city departments see sustained levels of funding and services, the Fire Department is the exception to that rule. Fire Department expenditures, not including fringe benefits, decline by \$966,000, or 1.3%.⁵ This largely reflects a new initiative that eliminates 24 fire fighter positions and replaces half with paramedics. This will allow for two two-person paramedic squads to be

⁵ All departmental expenditure changes discussed are net of fringe benefit costs and the recently negotiated wage increases for public safety departments.

established and directed to areas that have demonstrated high Emergency Medical Service (EMS) needs – one on the north side and the other on the south side of the city. The budget notes that medical response is the primary function of the fire department, accounting for 80% of all calls placed to the Fire Department. Eliminated fire fighter positions will cause the number of fire ladders that are out of service each day to be increased to four, which is up from two in 2011.

The proposed budget does not take into account the Milwaukee County executive's proposal to eliminate \$1.2 million in funding that has helped support the city's paramedic services for the past several years. City officials are considering strategies to address this issue should the reduction be adopted in the final county budget.

- *Neighborhood Services* – Due to substantial foreclosure activity, the 2012 proposed budget includes a \$925,000 (8%) expenditure increase for the Department of Neighborhood Services. This includes adding eight new city-funded positions to support greater foreclosure activity and transferring 5.5 more positions to the levy due to lost CDBG and ARRA grant funding. These resources will assist in expanding the city's ability to manage the roughly 6,000 properties currently in foreclosure.
- *Public Works – Operations* – The proposed budget increases funding for the Department of Public Works – Operations Division by approximately \$5 million. As mentioned earlier, this is due in part to the city's push to intensify its recycling program. In this effort, the city replaces \$1.1 million in lost recycling grant revenue received from the state with property tax levy. City-funded positions increase by 41.9 FTE, half of which were previously supported by the state recycling grant. The balance of the remaining position increase reflects the funding of additional authorized fleet and forestry positions.
- *Library* – The library budget increases by \$434,000, or 2.7%. This largely reflects \$441,000 in additional levy support for the Center Street Library, which previously received support from CDBG grant revenue. In 2012, library hours are increased by 44.5 hours per week and after-school education activities are enhanced. Cuts to library hours in 2010 caused attendance levels to dramatically drop that year, but restoration of library hours in 2011 and 2012 is projected to more than reverse that fall. The proposed budget increases the library's materials budget by \$58,700, or 4.1%.
- *Election Commission* – The Election Commission's budget increases substantially, by \$1.7 million, to reflect costs of several elections that will be held in 2012, including presidential primary and general elections. These elections are expected to also increase activity within the health department, where a significant number of residents likely will be requesting copies of birth certificates in order to comply with the new state Voter ID law.
- *Police* – The Police Department receives a slight increase of \$620,000, or less than 1%.⁶ 2012 will be the last full year in which the city will use ARRA funding, which has provided \$3 million annually to support 50 police officers. The three-year ARRA grant began in the middle of 2010 and will run out midway through 2013, meaning the city will have to find alternative funding sources to replace a half year of funding in 2013 and a full year of funding in 2014, or contemplate reductions in police personnel at that time.

⁶ All departmental expenditure changes discussed are net of fringe benefit costs and the recently negotiated wage increases for public safety departments.

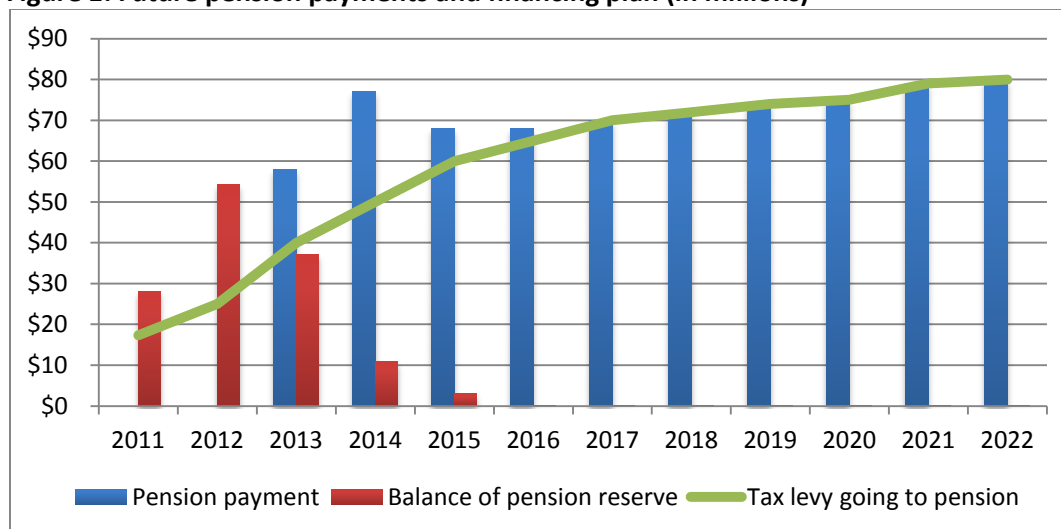
PREPARING FOR THE FUTURE

Rising pension payments

As discussed above, beginning in 2013, the city is expected to face several successive years of unprecedented actuarially required pension payments ranging from \$58 to \$80 million each year. While Milwaukee's pension system continues to be one of the best-funded public pension systems in the country – being funded at 104.4% as of January 1, 2011 – the funding ratio is projected to fall and remain between 91% and 97% for the next 10 years. When the funding ratio dips below 102%, the City Charter requires the city to make an actuarially determined pension payment.

City leaders have responsibly built up a healthy pension reserve that will ease the initial pressures to redirect property tax levy to pension payments. The pension reserve fund was projected to stand at \$27 million at the end of 2011, and the proposed budget's contribution of an additional \$25 million would build the reserve to a total of \$54 million by the end of next year. Nonetheless, as depicted in **Figure 1**, these reserves will quickly disappear as pension payments escalate.

Figure 1: Future pension payments and financing plan (in millions)*



* Based on current city estimates of future pension funding needs

Source: Reproduced from the City of Milwaukee's 2012 Proposed Plan and Executive Budget Summary

In 2013, the city anticipates meeting the projected contribution by using about \$18 million of its pension reserve and increasing its pension-related tax levy contribution by \$15 million (from the \$25 million voluntary contribution proposed in 2012 to \$40 million). This will create substantial pressure on departmental budgets that will continue into future budgets. It is also important to note that this scenario could worsen if the 8.5% annual investment return assumed in pension contribution calculations does not pan out, a distinct possibility given the current state of financial markets.

These pension payments will be increasingly difficult to accommodate should health care costs continue to rise, grant funds disappear, and the property tax levy remain flat. Consequently, city leaders have created a Pension Study Taskforce to consider strategies to reduce future pension liabilities, with a goal of possibly reducing the annual growth in pension liabilities from 5% to 3%. The pension fund actuary is currently studying the impacts of increasing the retirement age, reducing formula multipliers and making changes to annual cost of living adjustments, among other alterations. While such possibilities

may be needed to help mitigate future liability growth, the magnitude of the savings and timeframe in which they are realized depends on which plan design components are altered and to whom they can be legally applied.

The new property tax levy limit

In light of the new state property tax levy limit and the uncertainty regarding future growth in new construction, municipal finance officials across the state must be even more strategic and long-term in their thinking. Indeed, it is now imperative to ensure greater flexibility and capacity in annual operating budgets to accommodate future needs in the face of limited revenue elasticity.

By avoiding significant cuts to departmental budgets and building reserves in 2012, the city ostensibly meets that imperative by preserving some capacity to reallocate resources toward future pension payments without severe service-level consequences, at least in the short-term. A key question, however, is the extent of the city's preparedness for its anticipated *long-term* budget pressures, and its willingness to address those pressures with annual use of the state budget repair bill tools.

As suggested by the title of our 2009 report on city finances – “Between a Rock and a Hard Place”⁷ – city leaders traditionally have had few options to respond to growing fixed costs in the areas of fuel, materials and general health care, not to mention a huge spike in pension contributions. Now, with even less ability to increase the property tax to keep up with those costs, those leaders are likely to be in the unenviable position of choosing each year between impactful service reductions, or continuing to reduce compensation levels for non-public safety employees.

State of city reserves

While city leaders certainly deserve credit for their foresight in establishing and building reserves, the level of those reserves may soon be tested. Consequently, it might be asked whether the size of the proposed 2012 draw from the TSF, which is its largest general fund reserve, is appropriate given the city's likely inability to capture huge savings in fringe benefits next year. The \$13.8 million withdrawal proposed for 2012 is a decrease of \$833,000 from the 2011 withdrawal, but is substantial nonetheless. Should additional spending cuts or revenue increases be entertained in order to preserve a greater balance in the TSF?

As seen in **Table 5**, the city has withdrawn \$13 to \$29 million from the TSF in each of the past four years. Available fund balances noted at the time of budget adoption have declined from \$58.9 million in 2008 to \$29.2 million in 2012. While this decline is understandable in light of economic erosion and state revenue reductions, bond rating agencies previously have expressed concern over this trend. Given the city's upcoming challenges, and the fact that increased belt-tightening in annual budgets might limit the city's ability to realize sufficient surpluses to replenish reserves in the future, this is an area of the budget that merits scrutiny.

Table 5: TSF fund balances and withdrawals (in millions)

	2008	2009	2010	2011	2012
Prior year-end fund balance	\$58.9M	\$44.8M	\$25.5M	\$29.1M	\$29.2M
TSF withdrawal	\$29.5M	\$22.4M	\$13M	\$14.6M	\$13.8M

Source: City of Milwaukee, annual adopted budgets and the 2012 Proposed Plan and Executive Budget Summary

⁷ The report can be found at <http://www.publicpolicyforum.org/pdfs/CityOfMilwaukeeFiscalCondition.pdf>.

CAPITAL PROJECTS

Authorized funding for the city's 2012 capital plan is \$244.8 million for general and enterprise funds combined, which is \$9.5 million less than the amount authorized in 2011. An \$11.3 million reduction to Water Works projects explains much of this decline. The city intends to dramatically reduce its water main replacement program in 2012 due to years of declining water sales and revenue, and the delay in Public Service Commission consideration of a new rate structure. While the 2011 budget included capital funds to replace 12.2 miles of mains, the 2012 proposed budget would reduce that amount to 0.5 miles. This is an issue that will need to be carefully monitored in future budgets. The proposed budget does include a substantial commitment to sewer lines, however, authorizing an additional \$4.1 in capital spending for sewer maintenance, with a total of 15 miles of sewer lines to be replaced and 14 miles to be re-lined.

Funding for capital projects for general fund departments decline by \$1.8 million to \$116.1 million, though authorization for levy-supported general obligation (G.O.) debt increases from \$73.5 million in 2011 to \$77.5 million in 2012. Levy-supported debt would now comprise 66.7% of general fund capital spending, up from 62.3% in 2011. The largest components of levy-supported G.O. debt in the proposed budget are \$13 million for local street reconstruction and resurfacing;⁸ \$9.8 million for repairing major and minor arterials as part of the city's Major Streets program; \$8.2 million in improved street lighting; and \$7.8 million for local bridge reconstruction. These projects make up 50% of all levy-supported G.O. debt.

The Major Streets program is the city's largest capital program, receiving \$68.6 million in county, state and federal aid in addition to the \$9.8 million city match, for a total investment of \$78.3 million. This is an increase of \$18.5 million over 2011. In both years, these major street investments surpassed the more typical annual investment of \$30 million, which is expected to be the norm again in 2013. Funding proposed for 2012 will be used for 28 major street reconstruction projects.

⁸ The city has made substantial progress in decreasing its replacement cycle in recent years and hopes to further decrease the cycle from 62 to 50 years by 2017.

CONCLUSION

The major story line of the 2012 proposed budget is the use of dramatic savings in employee benefits to overcome the challenges associated with a substantial loss of state shared revenue and other state aids. A total of \$23.4 million in “net” savings is produced by the employee benefit changes minus the loss in state aids, and much of that is reinvested in departmental budgets. In fact, we find that when accounting for the decrease in employee benefit costs, departmental expenditures would increase slightly more than 6%, a level last seen in 2007.

To his credit, the mayor also directs about \$8 million of these savings to boost the city’s contribution to its pension reserve. It is hoped that the \$54 million in reserve at the end of 2012, as well as possible adjustments to pension benefits that are being considered by a newly created Pension Study Taskforce, will allow the city to manage the increasing pension contributions expected over the next decade.

The 2012 proposed budget also makes efforts to replace lost federal grant funding with increased property tax levy. This has allowed several services and new initiatives, including the city’s foreclosure initiative, to be maintained. Diminished grant revenue will continue to pose a challenge in future budgets, however, particularly when stimulus funds that currently support 50 police officers run out in 2013.

While the fiscal good fortune generated by the budget repair bill and the city’s creative approach to health care redesign makes 2012 a far less difficult budget year than many previous years, the good fortune may be short-lived. As pension contributions sharply escalate and fixed costs grow with inflation, while major revenue streams remain flat and reserves are depleted, city leaders may have few options to respond to annual cost pressures. The one option that is likely to be available – offsetting cost increases with equivalent reductions in non-public safety employee pay and benefits – will need to be weighed against possible impacts on the quality of the city’s workforce, and the equity of creating markedly different wage and benefit structures for different classes of city workers.

In the end, more help may be needed from Madison – either by applying budget repair bill provisions to public safety unions, restoring lost state aid, or providing additional revenue options – to avoid additional severe reductions to compensation for non-public safety workers, difficult cuts in valued services, or both.